Langton Capital Limited

15 July 2015

JD WETHERSPOON (JDW): 771p
Q4 2015 Update: Analysts' Conf. Call:

Says profits unlikely to move forward in FY16, labour costs will rise…

Year to end-July	PBT (£m)	EPS* (p)	PER (x)	DPS (p)	Yield (%)
2014 (A)	79.4	47.4	16.3	12.04	1.6
2015 (E)	78.2	48.1	16.0	12.12	1.6
2016 (E)	86.2	53.7	14.4	12.52	1.6

**Normalised, Source:* Company & Broker Estimates, 2015 upgrades likely

Q4 Trading Update: Conference Call:

Following its Q4 update, JD Wetherspoon this morning hosted a conference call for analysts and our comments thereon are set out below:

Expected Results, FY16 etc.:

- If FY16 is only 'slightly better', then should analysts be downgrading their numbers? Should be a 'flat to slightly better trading performance overall'. The mix as to where this comes from, new pubs, sales shifts, margin improvement, is not yet clear.
- Group is 'trying to avoid margin projections'.
- Why is it more difficult to forecast now than in the past? JDW says it would not like to give the misleading impression that it is absolutely sure how things will turn out
- When questioned on labour costs, the Co suggested that these pressures were behind the statement that profits would not be going up in FY16
- LfLs have picked up since the last update. Would like to think 'this is down to hard work & marketing'. Breakfasts have performed well. Magner's promo (199p) went well, etc.

Trading, Margin & Costs:

- Margin is down in Q4 130bps y-o-y; why? It was 'within the realms of guidance' and LfL sales were better. There was something of a sales shift to breakfasts etc.
- Group has found it 'rather difficult to put prices up'. Competition is intense both from the on-trade & the off-trade

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Market Cap: £910m
12m range 700p 850p

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- Living Wage? Declined to say how many are u25.
  - Can you transfer some of the bonus that is regularly paid into basic wages to avoid Living Wage increases? Bonus has helped group keep staff. Won't give more numbers other than to say that the 5% increase last year & planned 8% increase this year 'take the group away from the minimum wage'. The 8% rise relates to starting rates. It relates to hourly paid staff (c80% of total). Starts 3 August.
  - Increases in costs: these 'will be significant anyway, due to the prior decision to increase wages'. Adds 'not all of these costs will be off-settable'
  - Where are you on pay v other operators? No real stats. Group 'thinks it's doing the right thing'.
  - Are you seeing better employment KPIs as a result of paying more? Yes but this is movable as competitors also tend to react.
- Other costs? These may be in the 0% to 2% range.
- Adding accommodation? This is opportunistic but it is likely to continue.
- Progress on VAT cuts? Not really.
- How are you getting on with tripling your sales of coffee & breakfasts? To do this in 18mths would be a good performance. It is a stretching target. It's a slightly different crowd to customers who might otherwise have visited a coffee shop

Balance Sheet & Other:

- Openings beyond FY16? Pipeline remains healthy with a larger proportion of freeholds. The group is 'not chasing a numbers target'. No real further guidance on 1,500 to 1,600 'target'.
- More on the likely impairment? This is not related to the 20 pubs for disposal. The auditors have not yet reported on the situation
- Have you bought in more freeholds? Yes, one or two since Q3. They are opportunistic.
- Why sell the 20 units? Want to avoid giving further detail until after the transaction(s) are concluded. Some are sub-scale or in heavily-represented areas.
- Oversupply? There is capacity going on. Group has a good footprint but new entrants do increase the level of competition

Langton View: JD Wetherspoon has confirmed the suggestion made in its 7am announcement that FY16 numbers should come down.

The group guides that FY16 numbers should be in line with or only slightly better than FY15. Earlier forecasts had the group moving from perhaps £79m to £86m and it now appears likely that this will not happen.

Downgrades to around £80m (50.25p) may be appropriate and JDW's shares are currently down by around 5%.

This is understandable but, as the company has its eyes on the medium and longer term, it is entirely possible that JDW itself could end up buying back the shares that others are selling.

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It would appear that any downgrade is a function of trading improving less a larger amount of increased costs.

The latter, particularly labour costs, will be rising by more than sales but the impact of the higher Living Wage on sales remains to be seen. The propensity to spend of those benefiting from increased wages is likely to be high and JDW could and should be a beneficiary over the medium term.

Whilst this morning's share price weakness is an understandable reaction to the way in which JDW has broken the above news, we see the company as a premier performer and would use any material share price fall as an opportunity to increase holdings.

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